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No. 99-387

Supreme Court, U.S.
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In The

Supreme Court of the United States

THOMAS E. RALEIGH, Chapter 7 Trustee
For the Estate of William J. Stoecker,

Petitioner,

v.

STATE OF ILLINOIS,
DEPARTMENT OF REVENUE,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY BRIEF FOR PETITIONER

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87 pp

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

I. CONGRESS IS CONSTITUTIONALLY EMPOWERED TO DETERMINE THE LAWS GOVERNING BANKRUPTCY PROCEEDINGS, AND BY DECLINING TO DEPART FROM PRE-CODE PRACTICES, CONGRESS IS DEEMED TO HAVE EXERCISED THAT POWER IN ASSIGNING THE BURDEN OF PERSUASION TO ALL CLAIMANTS, INCLUDING TAXING AUTHORITIES, IN CLAIM OBJECTION PROCEEDINGS 1

II. IF CONGRESS IS NOT DEEMED TO HAVE ESTABLISHED A RULE FOR ALLOCATING THE BURDEN OF PERSUASION, THEN THE DUTY TO DO SO DEVOLVES UPON THE COURT..... 5

III. NEITHER *ERIE* NOR THE RULES OF DECISION ACT REQUIRES APPLICATION OF STATE LAW BURDENS OF PERSUASION..... 14

CONCLUSION 20

TABLE OF AUTHORITIES

Page

CASES

Aetna Ins. Co. v. Kennedy, 301 U.S. 389 (1937) 19

In re Arndt, 201 B.R. 853 (M.D. Fla. 1996) 13

Associates Commercial Corp. v. Rash, 520 U.S. 953 (1997) 14

Atherton v. FDIC, 519 U.S. 213 (1997) 8

Boyle v. United Tech. Corp., 487 U.S. 500 (1988) ... 6, 8, 9

In re Brown, 82 F.3d 801 (8th Cir. 1996) 13

Butner v. United States, 440 U.S. 48 (1979) 1, 13

In re Canady, 43 A.F.T.R.2d ¶ 79-360 (N.D. Ga. 1978) 4

Cannon v. University of Chicago, 441 U.S. 677 (1979) 2

City of New York v. Saper, 336 U.S. 328 (1949) 8

DelCostello v. International Bhd. of Teamsters, 462 U.S. 151 (1983) 15

Dick v. New York Life Ins. Co., 359 U.S. 437 (1959) 17

Erie R. Co. v. Tompkins, 304 U.S. 64 (1938) ... 14, 17, 18, 19

Fidelity Fin. Serv., Inc. v. Fink, 522 U.S. 211 (1998) 19

In re Fidelity Holding Co., 837 F.2d 696 (5th Cir. 1988) 13

Flood v. Kuhn, 407 U.S. 258 (1972) 2

Fore Improvement Corp. v. Selig, 278 F.2d 143 (2d Cir. 1960) 14, 16

In re Fullmer, 962 F.2d 1463 (10th Cir. 1992) 13

In re Garfield Bag & Stationery Co., 42 F. Supp. 708 (S.D.N.Y. 1941) 4

TABLE OF AUTHORITIES – Continued

Page

Garrett v. Moore-McCormack Co., 317 U.S. 239 (1942) 17

In re Glover-McConnell & Co., 9 F.2d 683 (N.D. Ga. 1925) 4

Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989) 19

Grogan v. Garner, 498 U.S. 279 (1991) 18

Guaranty Trust Co. v. York, 326 U.S. 99 (1945) 16, 19

Heiser v. Woodruff, 327 U.S. 726 (1946) 16

International Shoe Co. v. Pinkus, 287 U.S. 261 (1929) 1

Katchen v. Landy, 382 U.S. 323 (1966) 9, 19

Kelly v. Robinson, 479 U.S. 36 (1986) 4

Kuehner v. Irving Trust Co., 299 U.S. 445 (1937) 6

Langenkamp v. Culp, 498 U.S. 42 (1990) 19, 20

Levinson v. Deupree, 345 U.S. 648 (1953) 14

In re Lindsay, 59 F.3d 942 (9th Cir. 1995) 17

Local Loan Co. v. Hunt, 292 U.S. 234 (1934) 12

Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935) 1

In re Macfarlane, 83 F.3d 1041 (9th Cir. 1996) 13

Manhattan Properties, Inc. v. Irving Trust Co., 291 U.S. 320 (1934) 1

In re Menefee, 40 A.F.T.R.2d ¶ 77-5002 (E.D. Mo. 1977) 4

Miles v. Apex Marine Corp., 498 U.S. 19 (1990) 2

TABLE OF AUTHORITIES – Continued

Page

O'Melveny & Myers v. FDIC, 512 U.S. 79 (1994) 8

In re O'Neill, 80-2 U.S. Tax Cas. (CCH) ¶ 9716 (Bankr. W.D. Va. 1980) 3

In re Osborn, 4 B.R. 431 (W.D. Mo. 1979) 4

Prudence Realization Corp. v. Geist, 316 U.S. 89 (1942) 15

Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215 (1941) 9

Sexton v. Dreyfus, 219 U.S. 339 (1911) 16

Stellwagen v. Clum, 245 U.S. 605 (1918) 12

Teamsters Pension Trust Fund v. Littlejohn, 155 F.3d 206 (3d Cir. 1998) 11

In re Trustees Sys. Co., 30 F. Supp. 361 (W.D. Ky. 1939) 3

United States v. Energy Resources Co., 495 U.S. 545 (1990) 11

United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979) 7

United States v. Knox-Powell-Stockton Co., 83 F.2d 423 (9th Cir. 1936) 3

United States v. Little Lake Misere Land Co., 412 U.S. 580 (1973) 6, 11

United States v. Ron Pair Enter., Inc., 489 U.S. 235 (1989) 5, 9

TABLE OF AUTHORITIES – Continued

Page

United States v. Standard Oil Co., 332 U.S. 301 (1947) 14, 15

United States v. Whiting Pools, Inc., 462 U.S. 198 (1983) 2

In re Ward, 131 F. Supp. 387 (D. Colo. 1955) 3

Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156 (1946) 7, 9, 11, 18

Wright v. Union Central Life Ins. Co., 304 U.S. 502 (1938) 2

Young v. Higbee Co., 324 U.S. 204 (1945) 9

CONSTITUTION AND STATUTES

U.S. Const., Art. I, § 8, cl. 4 1

11 U.S.C. § 341 19

11 U.S.C. § 502 ..... 12, 14

11 U.S.C. § 502(a) 16

11 U.S.C. § 502(b)(9) 19

11 U.S.C. § 506(a) 14

11 U.S.C. § 523(a)(1) 13

11 U.S.C. § 704(5) 16

11 U.S.C. § 727(a)(3) 13

11 U.S.C. § 1106 17

11 U.S.C. § 1107(a) 17

11 U.S.C. § 1325(a)(5)(B) 14

28 U.S.C. § 1652 14

TABLE OF AUTHORITIES – Continued

Page

RULES

Fed. R. Bankr. P. 3002(c) 19

Fed. R. Bankr. P. 3003(c)(3) 19

ARTICLES AND TREATISES

V. Countryman, *The Use of State Law in Bankruptcy Cases (Part I)*, 47 N.Y.U. L. Rev. 407 (1972) .. 7, 14, 16

E. Martin, *Burden of Persuasion: The Overlooked Defense to Tax Claims*, 21 Cal. Bankr. J. 117 (1993) 10

P. Mishkin, *The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision*, 105 U. Pa. L. Rev. 797 (1957) 6, 12, 15

3A J. Moore & L. King, *Collier on Bankruptcy* (14th ed. 1975) 4, 5

2 H. Remington, *A Treatise on the Bankruptcy Law of the United States* (rev. ed. 1956) 5

I.

CONGRESS IS CONSTITUTIONALLY EMPOWERED TO DETERMINE THE LAWS GOVERNING BANKRUPTCY PROCEEDINGS, AND BY DECLINING TO DEPART FROM PRE-CODE PRACTICES, CONGRESS IS DEEMED TO HAVE EXERCISED THAT POWER IN ASSIGNING THE BURDEN OF PERSUASION TO ALL CLAIMANTS, INCLUDING TAXING AUTHORITIES, IN CLAIM OBJECTION PROCEEDINGS.

The Constitution grants to Congress the authority to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const., Art. I, § 8, cl. 4. Congress is thus constitutionally empowered to determine the applicable law in all aspects of bankruptcy proceedings. *See International Shoe Co. v. Pinkus*, 278 U.S. 261, 265 (1929) ("The power of Congress to establish uniform laws on the subject of bankruptcies throughout the United States is unrestricted and paramount."); *see also Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 589 (1935) ("Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the states, it is not prohibited from impairing the obligations of contracts."); *Manhattan Properties, Inc. v. Irving Trust Co.*, 291 U.S. 320, 332 (1934) ("The issue [of bankruptcy claimant's right to recover on a claim for future rent] is not one of power, for plainly Congress may permit such claims or exclude them. The sole inquiry is the intent of the act."); *Butner v. United States*, 440 U.S. 48, 54 (1979) ("The constitutional authority of Congress to establish 'uniform Laws on the subject of Bankruptcies throughout the United States' would clearly encompass a federal statute defining the mortgagee's interest in the rents and profits earned by property in a bankrupt estate.").

Congress possesses a constitutional grant of power to alter creditors' rights arising outside of bankruptcy when those rights are made part of the bankruptcy process.

Indeed, the very notion of bankruptcy relief entails modification of state-created rights in one fashion or another, the most obvious example being discharge, in which such rights are erased in their entirety. *See Wright v. Union Central Life Ins. Co.*, 304 U.S. 502, 517 (1938) ("If the argument is that Congress has no power to alter property rights, because the regulation of rights in property is a matter reserved to the States, it is futile. Bankruptcy proceedings constantly modify and affect the property rights established by state law.").

It being undisputed that Congress has the power to determine how the burden of persuasion is to be allocated in bankruptcy proceedings, the question presented here is whether Congress has done so. The Bankruptcy Act, like the current Bankruptcy Code, was silent on the issue of allocation of burden of persuasion in claim objection proceedings. By not altering the general judicial practice under the Bankruptcy Act of allocating to all claimants (including taxing authorities) the burden of persuasion on their claims, however, Congress is deemed to have carried forward that practice under the Code. Congress, which is presumed to have known of the prior practice and took no action to change it, is assumed to have intended that the prior practice continue. *See Miles v. Apex Marine Corp.*, 498 U.S. 19, 32 (1990) ("When Congress passed the Jones Act, the *Vreeland* gloss on FELA, and the hoary tradition behind it, were well established. Incorporating FELA unaltered into the Jones Act, Congress must have intended to incorporate the pecuniary limitation on damages as well."); *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 208 (1983) ("this interpretation of § 542 in the reorganization context is consistent with judicial precedent predating the Bankruptcy Code. . . . Nothing in the legislative history evinces a congressional intent to depart from that practice. . . . "); *Flood v. Kuhn*, 407 U.S. 258, 283-84 (1972) (declining to overturn longstanding judicial interpretation of statute where Congress, "by its positive inaction, has allowed those decisions to stand"); *Cannon v. University of Chicago*, 441 U.S. 677, 696-98 (1979) (implied private right of action

existed under Title IX; where Congress repeatedly referred to Title VI and its modes of enforcement in the course of enacting Title IX, it can be presumed that Congress was aware of numerous federal court decisions prior to Title IX's enactment which held that an implied private right of action existed under Title VI).

The Department and the *amici curiae* dispute that the predominant pre-Code practice allocated the burden of persuasion to taxing authorities. They contend that "the majority of lower federal court decisions considering tax claims in bankruptcy in fact employed the burden of proof from state or federal substantive tax law" (Dept. Br. 39), *i.e.*, allocated the burden of persuasion to the objector. In fact, many of the cases cited in support of this proposition – none of which purports to state the "majority rule" – appear to address not the burden of persuasion, but the burden of the objecting party to come forward with evidence sufficient to rebut the taxing authority's *prima facie* case.[1] Other cases cited by the Department and *amici* are

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[1] *See United States v. Knox-Powell-Stockton Co.*, 83 F.2d 423, 425 (9th Cir. 1936) ("The burden is upon the taxpayer to show what part, if any, of the moneys received was not income. Having failed to do so, the prima facie showing of the assessment is not overcome, and the tax must be sustained."); *In re Trustees Sys. Co.*, 30 F. Supp. 361, 365 (W.D. Ky. 1939) ("The question raised is whether the debtor-plaintiff's evidence is sufficient to rebut the presumptions against it. Full and conclusive proof is not required but it should be at least sufficient to render the existence of the negative probable in order to overcome the presumptions. Giving due weight, credit and value to the aggregate evidence, I am of the opinion it sufficiently meets the defendant's prima facie case to shift the burden to it to prove that the additional credits were in fact income."); *In re O'Neill*, 80-2 U.S. Tax Cas. (CCH) ¶ 9716, at 85,346 (Bankr. W.D. Va. 1980) ("Procedurally, there is a presumption the assessment of tax by Internal Revenue Service is accurate. This presumption transfers to the taxpayer the burden of going forward with evidence.") (citations omitted); *In*

distinguishable by their factual and procedural contexts.[2] Furthermore, the position of the Department and *amici* cannot be reconciled with the summary of case law in a late pre-Code version of *Collier on Bankruptcy* that "[a]s in the case of other types of claims, a filed proof of a tax claim in proper form establishes a *prima facie* case for the allowance of the claim. The burden of proof is on the claimant, but the burden of going forward and introducing evidence to rebut the *prima facie* case is on the objecting party." 3A J. Moore & L. King, *Collier on Bankruptcy* ¶ 64.409 at 2244-45 (14th ed. 1975).[3] Other pre-Code

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re Ward, 131 F. Supp. 387, 394 (D. Colo. 1955) ("The government offered no witnesses; it depended entirely and alone upon its assessment and the presumption arising therefrom. . . . All of the testimony adduced by the Trustee considered, the credibility of the witnesses given the weight and effect above stated, and the dependence of the government upon its presumption alone, leads to no other conclusion than that the Trustee has fully sustained the burden imposed upon him."); *In re Garfield Bag & Stationery Co.*, 42 F. Supp. 708, 711 (S.D.N.Y. 1941) ("The Trustee not having rebutted the prima facie evidence of the validity of the City's proof of claim, the Referee was in error in not allowing the claim."); *In re Osborn*, 4 B.R. 431, 435 (W.D. Mo. 1979) ("The applicable law, under these circumstances, is to the effect that the certified assessment is entitled to the presumption of correctness and the presumption prevails when no contradictory evidence is adduced.").

[2] *See In re Canady*, 43 A.F.T.R.2d ¶ 79-360, at 79-472 (N.D. Ga. 1978) (debtor brought adversary proceeding to challenge post-petition tax claim); *In re Menefee*, 40 A.F.T.R.2d ¶ 77-5002, at 77-5013 & n.19 (E.D. Mo. 1977) (holding that upon showing by government that taxpayer committed fraud, taxpayer has burden to set aside re-determination of taxes by government); *In re Glover-McConnell Co.*, 9 F.2d 683, 685-86 (N.D. Ga. 1925) (holding that debtor had burden of persuasion on affirmative defense of statute of limitations).

[3] The Court has previously recognized *Collier* as providing an authoritative statement of pre-Code practice. *See Kelly v. Robinson*, 479 U.S. 36, 45-46 (1986) (citing *Collier* regarding scope of discharge).

commentators agreed with *Collier*. *See* 2 H. Remington, *A Treatise on the Bankruptcy Law of the United States* § 1046 at 503 (rev. ed. 1956) ("Government tax claims have sometimes been regarded as on the sacrosanct side, though there is no justification for this. Such a claim is simply an ordinary claim. It is true that tax statutes often place a burden of proof on the taxpayer which would rest on the opposite party in ordinary litigation, but this is a peculiarity of tax law, not of bankruptcy law.").

In many contexts, Congress altered existing bankruptcy practice by incorporating specific provisions in the Code, *see United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 240 (1989), but this is not one of those instances. While Congress inserted certain tax-specific provisions into the Code, nothing in the Code or its legislative history indicates congressional intent to alter general pre-Code practice by creating a special exemption relieving taxing authorities of the burden of persuasion in claim objection proceedings.

II.

IF CONGRESS IS NOT DEEMED TO HAVE ESTABLISHED A RULE FOR ALLOCATING THE BURDEN OF PERSUASION, THEN THE DUTY TO DO SO DEVOLVES UPON THE COURT.

In the absence of specification by Congress, the task of choosing the source of the law governing a particular aspect of a federal statutory scheme becomes a task for the courts:

> Constitutionalism requires recognition of power in the federal courts to declare, as a matter of common law or "judicial legislation," rules which may be necessary to fill in interstitially or otherwise effectuate the statutory patterns enacted in the large by Congress. In other words, it must mean recognition of federal judicial competence

> to declare the governing law in an area comprising issues substantially related to an established program of government operation.
>
> . . .
>
> Where Congress has specifically made its choice – either by adoption of state law or by specifying a substantive rule for decisions – that choice of course governs without more. Where no such direction is provided, and yet the matter at issue is substantially related to a going national program, the selection of the source of governing rule devolves upon the courts. The problem then is identifying the criteria for choice.

P. Mishkin, *The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision*, 105 U. Pa. L. Rev. 797, 800, 811 (1957) ("Mishkin"). *See United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 593 (1973) (citing Mishkin and noting that "the inevitable incompleteness presented by all legislation means that interstitial federal lawmaking is a basic responsibility of the federal courts"). *See also Boyle v. United Tech. Corp.*, 487 U.S. 500, 504 (1988) ("But we have held that a few areas, involving 'uniquely federal interests' . . . are so committed by the Constitution and laws of the United States to federal control that state law is preempted and replaced, where necessary, by federal law of a content prescribed (absent explicit statutory directive) by the courts – so-called 'federal common law'.") (citations omitted).

Because of Congress's constitutionally conferred power to establish the laws governing all aspects of bankruptcy, the determination of which party bears the burden of persuasion in claim objection proceedings is a matter of legislative prerogative. *See Kuehner v. Irving Trust Co.*, 299 U.S. 445, 451 (1937) ("Congress, in determining what . . . an equitable distribution demands, is free to establish standards of provability and measures of allowance regardless of the claimant's ability to maintain an action in a court or the measure of his recovery in such

an action if maintainable."). When Congress fails to act, it becomes a matter of judicial prerogative, with the courts taking into account the same policy considerations as would Congress. In *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979), the Court discussed the framework for choosing a rule of decision in the absence of a Congressional choice:

> Controversies directly affecting the operations of federal programs, although governed by federal law, do not inevitably require resort to uniform federal rules. Whether to adopt state law or to fashion a nationwide federal rule is a matter of judicial policy "dependent upon a variety of considerations always relevant to the nature of the specific governmental interests and to the effects upon them of applying state law."
>
> Undoubtedly, federal programs that "by their nature are and must be uniform in character throughout the Nation" necessitate formulation of controlling federal rules. Conversely, when there is little need for a nationally uniform body of law, state law may be incorporated as the federal rule of decision. Apart from considerations of uniformity, we must also determine whether application of state law would frustrate specific objectives of the federal programs. If so, we must fashion special rules solicitous of those federal interests.

440 U.S. at 727-28 (citations omitted). *See Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 162 (1946) (In choosing to apply a uniform federal rule denying interest on interest on creditor claims – rather than choose between two arguably applicable state law rules – the Court noted that, the issue was to be determined on the basis of which rule was better "compatible with the policy of the Bankruptcy Act.").[4] *See also* V. Countryman, *The Use*

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[4] The Department and *amici* argue that the Trustee misinterprets *Vanston* because the Trustee does not take into

of State Law in Bankruptcy Cases (Part I), 47 N.Y.U. L. Rev. 407, 428-30 (1972) ("Countryman"). Thus, in the absence of congressional choice, it is the Court's prerogative to fashion the appropriate rule governing the allocation of the burden of persuasion in claim objection proceedings.

The Department argues that "[f]ederal common law may displace state law to fill gaps in a federal statutory scheme, but it does so only in instances where there is 'a significant conflict between some federal policy or interest and the use of state law.' *Atherton*, 519 U.S. at 218 (quoting *O'Melveny*, 512 U.S. at 87)." (Dept. Br. 35.) The term "displacement" as used by the federal courts in this context refers to the decision of the court whether to fashion a uniform federal rule or to adopt state law to provide a rule of decision in a federal legislative scheme:

> We refer here to the displacement of state law, although it is possible to analyze it as the displacement of federal-law reference to state law for the rule of decision. Some of our cases appear to regard the area in which a uniquely federal interest exists as being entirely governed by federal law, with federal law deigning to "borro[w]" . . . or "incorporat[e]" or "adopt" . . . state law except where a significant conflict with federal policy exists. We see nothing to be gained by expanding the theoretical scope of the federal preemption beyond its practical effect, and so adopt the more modest terminology. If the distinction between displacement of state law and displacement of federal law's incorporation of state law ever makes a practical difference, it at least does not do so in the present case.

Boyle v. United Tech. Corp., 487 U.S. 500, 507 n.3 (1988).

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account the pre-Code distinction between "proof" and "allowance" of claims. This distinction is irrelevant to the ruling in *Vanston*, namely, the enunciation of a federal principle that a bankruptcy creditor is not entitled to interest on interest. *See City of New York v. Saper*, 336 U.S. 328 (1949).

In the instant case, a uniform federal rule placing the burden of persuasion on all claimants is warranted because a " 'significant conflict' exists between an identifiable 'federal policy or interest and the [operation] of state law' . . . [and because] . . . the application of state law [burdens of persuasion] would 'frustrate specific objectives' of federal legislation." *Id.* at 507 (citations omitted). Fundamental federal interests and policy considerations militate in favor of the uniform allocation of the burden of persuasion to bankruptcy claimants, including taxing authorities. "[H]istorically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets; to protect the creditors from one another." *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945); *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941). As the Court stated in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), "the touchstone of each decision on allowance of interest in bankruptcy . . . has been a balance of equities between creditor and creditor or between creditors and the debtor." *Id.* at 248 (citation omitted). *See also Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 165 (1946) (same); *Katchen v. Landy*, 382 U.S. 323, 329 (1966) ("This power to allow or to disallow claims includes 'full power to inquire into the validity of any alleged debt or obligation of the bankrupt upon which a demand or a claim against the estate is based.' ") (citations omitted).

When a tax claim is litigated prior to bankruptcy, there are only two parties in interest, the taxing authority and the taxpayer. After the taxpayer files or is placed in bankruptcy, however, the primary parties in interest are the debtor's creditors, each of whom is vying for a share of the bankruptcy *res*. In this context, state law elements of any particular creditor's claim (whether arising in contract, tort or by operation of statute) are applicable to determine whether the creditor has a valid claim. Burdens of persuasion are different: burdens of persuasion do not define the elements of a claim, but go to the apportionment of risk

between litigants. A state law burden of persuasion governing the allocation of risk between a taxing authority and a taxpayer has no applicability in the bankruptcy context where the true parties in interest are no longer the taxing authority and the taxpayer but are, instead, the taxing authority and all the other creditors of the estate, and where the issue is the equitable division of estate assets among creditors.

The Bankruptcy Code's fundamental policies and objectives of equality of treatment of creditors are put at risk if one class of creditors is given the benefit of a favorable presumption that is unavailable to other creditors. Adopting nonbankruptcy burdens of persuasion (be they state or federal[5]) to relieve taxing authorities of the burden of persuasion to establish their claims improperly disrupts the balance of equities among creditors in bankruptcy estates. The only rule that serves the federal interests and does not frustrate the objectives of the Bankruptcy Code is a uniform federal rule placing the same burden of persuasion on all creditors, including taxing authorities, in claim objection proceedings.

With regard to the issue of equality of treatment, the Department responds that "the rights of all creditors are a matter of state law" and that "[n]o bankruptcy policy is thwarted simply because state law gives one creditor greater rights than another." (Dept. Br. 29-30.) The error with this analysis is that, under the Bankruptcy Code, state law rights of creditors are altered. The Department's assumption that state law governs all aspects of the claims allowance process in bankruptcy proceedings is clearly wrong, and whether a specific aspect of state-created rights – the burden of persuasion – should apply in claims allowance proceedings is precisely the question to be

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[5] One commentator has noted that with respect to federal tax claims, the "burden of persuasion differs somewhat in each of the three federal courts with jurisdiction in tax matters." E. Martin, *Burden of Persuasion: The Overlooked Defense To Tax Claims*, 21 Cal. Bankr. J. 117, 120 (1993).

decided here. *Accord United States v. Energy Resources Co.*, 495 U.S. 545, 549 (1990) (A "bankruptcy court has the authority to order the IRS to apply the payments to trust fund liabilities if the bankruptcy court determines that this designation is necessary to the success of a reorganization plan. . . . [B]ankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships.").

It is important to note that a decision to assign the burden of persuasion to the Department is by no means a general repudiation of the applicability of Illinois law to the substantive issue of whether the Department has a valid claim. While state law may generally govern the rights and liabilities of parties in claim objection proceedings, particular aspects of state law – as to which there are countervailing federal considerations – should not apply. *See United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 594-95 (1973); *Teamsters Pension Trust Fund v. Littlejohn*, 155 F.3d 206, 209 (3d Cir. 1998) (while federal courts have looked to state law to formulate rules to fill gaps in ERISA, "it is important that the federal courts . . . do not strictly adhere to a single state's law at the expense of . . . furthering the policies of ERISA"). Thus, while "in the absence of overruling federal law, [the validity of claims] is to be determined by reference to state law," *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 161 (1946), it is left to the Court to determine how much and what aspects of state law apply. If portions of state law are inimical to or inconsistent with the purposes of the federal statutory scheme, those portions of state law should not be applied.

> [A] decision to apply state law as a matter of federal incorporation does not necessarily carry with it the obligation to adhere to the range and techniques which have been held to govern under *Erie*; there remains a freedom, after decision to incorporate local law, to control the extent and methods of that adoption which is not present when a determination has been made that

> state law will apply because the court has no competence to do otherwise.
>
> . . .
>
> Since the issue's outcome bears some relationship to a federal program, no rule may be applied which would not be wholly in accord with that program.

Mishkin at 804, 805-06. *See also Stellwagen v. Clum*, 245 U.S. 605, 613 (1918); *Local Loan Co. v. Hunt*, 292 U.S. 234, 243-44 (1934).

The Department argues in the alternative that federal common law does not "supplement the Code in all matters where the Code is silent." (Dept. Br. 33.) "It is simply an aid to construction when Code provisions are unclear." (*Id.*) The Department cites no authority for the proposition that "federal common law" may be employed only for the purpose of interpreting a particular Code provision. The Department's contention also ignores the nature of the task the Court is called upon to undertake, namely, to decide which law (be it state or federal) is better suited to address a particular matter left unaddressed by Congress in a federal statutory scheme. In any event, there is a specific Code section to be interpreted and illuminated here, 11 U.S.C. § 502, governing the allowance of claims in bankruptcy proceedings.

The Department and *amici* also make the policy argument that dire consequences will result if the Trustee's position is adopted. According to the Department and *amici*, adoption of the Trustee's position would lead to an intolerable situation, with tax delinquents lining up to file bankruptcy and placing the entire system of tax collection in disarray. The problem with this prediction is that, for a substantial portion of the country, the Trustee's position *is* the law, and has been for some time. In four circuits, covering fully half the states, the burden of persuasion

rests with the taxing authorities on objections to their claims in bankruptcy.[6]

None of the dire consequences predicted by the Department and *amici* has come to pass for obvious reasons. Bankruptcy is not a safe haven for tax delinquents. Taxpayers with inadequate records fare no better in bankruptcy court than in nonbankruptcy forums. Without adequate records, debtors are not able to rebut the *prima facie* evidence established by a taxing authority's proof of claim. Failure to maintain adequate records also may lead to the denial of an individual debtor's discharge, 11 U.S.C. § 727(a)(3), and may lead to the appointment of a trustee in a chapter 11 case or conversion to chapter 7. Furthermore, because a debtor's tax obligations are largely nondischargeable, the taxing authority can always pursue the debtor directly outside of bankruptcy. *See* 11 U.S.C. § 523(a)(1).

Contrary to the contention of the Department and *amici*, *Butner v. United States*, 440 U.S. 48 (1979), does not dictate a contrary result. In *Butner*, the Court declined to create a federal rule regarding a mortgagee's entitlement to rents where Congress had chosen not to exercise its constitutional power to do so. The Court stated that Congress had "generally left the determination of property rights in the assets of a bankrupt's estate to state law. . . . [and] [u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.* at 54-55. By contrast, in the present case, fundamental federal interests and the specific objectives and goals of the bankruptcy process are frustrated unless all creditors, including taxing authorities, are required to shoulder the same burden of

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[6] *See In re Fidelity Holding Co.*, 837 F.2d 696, 698 (5th Cir. 1988); *In re Fullmer*, 962 F.2d 1463, 1466-67 (10th Cir. 1992); *In re Brown*, 82 F.3d 801, 805 (8th Cir. 1996); *In re Macfarlane*, 83 F.3d 1041, 1044-45 (9th Cir. 1996). *See also In re Arndt*, 201 B.R. 853, 857-58 (M.D. Fla. 1996).

persuasion in claim objection proceedings. *Cf. Associates Commercial Corp. v. Rash*, 520 U.S. 953, 964-65 (1997) (In order to "serve the interests of predictability and uniformity" and rather than incorporate standards from applicable state law, the Court fashioned a federal rule under 11 U.S.C. § 506(a) to determine "value" of collateral retained by the debtor because of the debtor's exercise of "cram down" rights under 11 U.S.C. § 1325(a)(5)(B).).

III.

NEITHER *ERIE* NOR THE RULES OF DECISION ACT REQUIRES APPLICATION OF STATE LAW BURDENS OF PERSUASION.

The contention of the *amici* that, in the absence of a directive from Congress, *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938), and the Rules of Decision Act, 28 U.S.C. § 1652, dictate the application of state law burdens of persuasion is wrong. The "great object" of *Erie* "was to secure in the federal courts, in diversity cases, the application of the same substantive law as would control if the suit were brought in the courts of the state where the federal court sits." *United States v. Standard Oil Co.*, 332 U.S. 301, 307 (1947). Objections to claims in bankruptcy proceedings are not litigated in federal court because of the happenstance of the citizenship of the litigants or because of pendent federal jurisdiction, but rather as part of a constitutionally mandated, comprehensive federal statutory framework. The instant case does not implicate considerations of the uniformity of result as to litigation of state law claims in state versus federal courts, and *Erie* has no application here. *See Levinson v. Deupree*, 345 U.S. 648, 651 (1953); *Fore Improvement Corp. v. Selig*, 278 F.2d 143, 147 (2d Cir. 1960) (Friendly, J., concurring). *See also* Countryman at 409-11.

The question presented in this case is whether a taxing authority should bear the burden of persuasion on an objection to the allowance of its proof of claim in a bankruptcy proceeding under section 502 of the Bankruptcy Code. Neither *Erie* nor the Rules of Decision Act has any

role to play in the exercise of legislative or judicial prerogative in the selection of law to govern the operation of, or adjudication of rights under, a federal statutory scheme. *DelCostello v. International Bhd. of Teamsters*, 462 U.S. 151, 159 n.13 (1983) ("[N]either *Erie* nor the Rules of Decision Act can now be taken as establishing a *mandatory* rule that we apply state law in federal interstices.") (emphasis in original; citations omitted); *United States v. Standard Oil*, 332 U.S. 301, 307 (1947) ("the Erie decision, which related only to the law to be applied in exercise of that [*i.e.*, diversity] jurisdiction, had no effect, and was intended to have none, to bring within the governance of state law matters exclusively federal, because made so by constitutional or valid congressional command"). As Professor Mishkin explains:

> *Erie* . . . is not controlling on problems implicated in the operation of a congressional program. From this aspect, *Erie*'s basic holding was a determination that the particular subject matter involved was beyond the law-making competence of the federal courts; that the area was one where state law governed of its own authority, and the mere grant of jurisdiction to adjudicate a case did not carry with it the power to declare an independent "general" rule displacing that authority. These propositions are inapposite to problems which bear substantial relation to an established federal operation. As to such questions, state law cannot govern of its own force; there must be competence in the federal judiciary to declare the governing law.

Mishkin at 799.

These principles apply to the federal scheme created by the bankruptcy statute. *See Prudence Realization Corp. v. Geist*, 316 U.S. 89, 95 (1942) ("Nothing decided in Erie Railroad Co. v. Tompkins, supra, requires a court of bankruptcy to apply such a local rule governing the liquidation of insolvent estates. The bankruptcy act prescribes its own criteria for distribution to creditors. In the interpretation

and application of federal statutes, federal not local law applies."); *Heiser v. Woodruff*, 327 U.S. 726, 732 (1946) ("For nothing decided in Erie R. Co. v. Tompkins, supra, requires a court of bankruptcy, in applying the statutes of the United States governing the liquidation of bankrupts' estates, to adopt local rules of law in determining what claims are provable, or to be allowed, or how the bankrupt's estate is to be distributed among claimants."); *Fore Improvement Corp. v. Selig*, 278 F.2d 143, 147 (2d Cir. 1960) (Friendly, J., concurring) ("Of course, Congress is not required to direct the federal courts to look to state law for the definition of state-created rights asserted in bankruptcy, as it is when federal jurisdiction rests solely on diversity of citizenship. The question is of intent, not of power."). *See also* Countryman at 411.

Furthermore, and again contrary to the arguments of *amici*, *Erie* can have no application here because there could not have been "an action upon the same claim by the same parties in a state court." *See Guaranty Trust Co. v. York*, 326 U.S. 99, 109 (1945). When a proof of claim is filed in a bankruptcy proceeding, allowance of that claim (though the claim is predicated on a state-created right) is determined only as part of the bankruptcy process. Bankruptcy transforms claims against a debtor into an equitable division of a *res* among the debtor's creditors. *Accord Sexton v. Dreyfus*, 219 U.S. 339, 345 (1911) ("At that moment the creditors acquire a right *in rem* against the assets."). Creditors in a bankruptcy proceeding are no longer asserting claims against the debtor, but rather against the assets of the debtor's estate. The dispute is no longer creditor versus debtor but, rather, the dispute is among all the creditors of the estate as they vie for a share of the available assets. The bankruptcy trustee's statutory obligation to object to claims, 11 U.S.C. § 704(5), and the statutory ability of a creditor, creditors' committee, or other "party in interest", 11 U.S.C. § 502(a), to object to a creditor's claim exist only in the context of bankruptcy

proceedings.[7] Accordingly, the linchpin of the *Erie* analysis – that the same result should obtain in federal court as in state court on the same claims between the same parties – is missing. The parties are different, the claims are different, the comparable state law forum is non-existent,[8] and the interests at stake are different.

The Department's argument that state law should be applied here because burdens of persuasion are "substantive" rather than "procedural" is predicated on a distinction with no meaning or applicability in the present context. The substantive/procedural distinction is relevant when a court is mandated to apply the substantive law of a jurisdiction other than its own. *See Garrett v. Moore-McCormack Co.*, 317 U.S. 239, 245, 249 (1942) (In adjudicating a Jones Act claim, a state court is required to apply the burden of proof specified in federal law. The state court in such a case is required to ensure that "all the substantial rights of the parties under controlling federal law would be protected."); *Dick v. New York Life Ins. Co.*, 359 U.S. 437, 446 (1959) (federal court sitting in diversity is required by *Erie* to apply substantive state law, including state law concerning burden of proof). However, the distinction is irrelevant in a case such as this where the determination of the governing law is constitutionally a matter of legislative prerogative, and, in the absence of congressional action, a matter of judicial prerogative.

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[7] A chapter 11 debtor similarly acts as a "debtor-in-possession" with fiduciary obligations to act in the best interests of creditors of its estate. *See* 11 U.S.C. §§ 1106, 1107(a).

[8] "In federal question cases with exclusive jurisdiction in federal court, such as bankruptcy . . . , the risk of forum shopping which is avoided by applying state law has no application, because *the case can only be litigated in federal court*. The value of national uniformity of approach need not be subordinated, therefore, to differences in state choice of law rules." *In re Lindsay*, 59 F.3d 942, 948 (9th Cir. 1995) (citations omitted; emphasis added).

The Department tacitly acknowledges this, but attempts to salvage the substantive/procedural distinction by arguing that the burden of persuasion should be treated as inherently substantive, and not merely substantive because of *Erie*: "Although burdens of proof are substantive for purposes of *Erie*, they are not, as the Trustee suggests, substantive because of *Erie*." (Dept. Br. 17.) But the substantive/procedural distinction is meaningless when divorced from a context such as *Erie* in which the court is mandated to apply the substantive law of another jurisdiction.

In the present context, for example, the distinction has no meaning because, whether a state law is characterized as substantive or procedural, it will be applied only if Congress (or the Court) sees fit to do so. The mere attaching of the "substantive" label to a state law will not save it from being overridden by supervening federal bankruptcy principles. Or, to put it another way, the "substantive" label is no guaranty that the state law will be selected for application in the bankruptcy context. Thus, in *Grogan v. Garner*, 498 U.S. 279 (1991), federal rather than state law was held to govern the "substantive" issue of the burden of proof applicable to the dischargeability of a state law claim against the debtor.[9] Similarly, although statutes of

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[9] The Council of State Governments argues that: "[C]ontrary to Petitioner's assertion, *Grogan* only confirms that under the Bankruptcy Code of 1978, as was the case pre-Code, the 'validity of a creditor's claim [in bankruptcy court] is determined by rules of state law.' 498 U.S. at 283 (citing *Vanston*, 329 U.S. at 161)." (Council Br. 12.) The Court's decision in *Vanston*, upon which *Grogan* relies, states that the determination of allowance of claims in a bankruptcy estate does not implicate *Erie*, but rather "bankruptcy courts must administer and enforce the Bankruptcy Act as interpreted by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equitable principles." *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 162-63 (1946).

limitations are deemed "substantive" for purposes of *Erie* analysis, *see Guaranty Trust Co. v. York*, 326 U.S. 99 (1945), state law statutes of limitations are displaced in bankruptcy proceedings. Dates set for the filing of proofs of claim – whether by Bankruptcy Rule in a chapter 7, 12 or 13 proceeding, or by the bankruptcy court in a Chapter 9 or 11 proceeding – trump state law statutes of limitations. Thus, a creditor possessing a claim for breach of written contract against a chapter 7 debtor who ordinarily would have several years to file suit under the applicable state statute of limitations, must file a proof of claim within the truncated period set forth in Bankruptcy Rule 3002(c).[10] *See also Fidelity Fin. Serv., Inc. v. Fink*, 522 U.S. 211, 220-21 (1998) (time period within which secured party must perfect security interest to prevent avoidance by trustee determined by federal, not state, law).[11]

The Bankruptcy Code is a comprehensive statutory framework setting forth the mechanisms whereby the

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[10] Rule 3002(c) provides that in cases under Chapters 7, 12, and 13 of the Code, proofs of claim must be filed within 90 days of the first date set for meetings of creditors under section 341 of the Code. Rule 3003(c)(3) provides that the bankruptcy court shall set a bar date in Chapter 11 cases. With limited exceptions, the failure to file a proof of claim by the applicable bar date results in the disallowance of the claim. 11 U.S.C. § 502(b)(9).

[11] The right to a jury trial – among the most fundamental of all rights, *Aetna Ins. Co. v. Kennedy*, 301 U.S. 389, 393 (1937) – is also lost by creditors who file proofs of claim in bankruptcy, not only with respect to their own claims, but on the estate's claims against them as well. *Langenkamp v. Culp*, 498 U.S. 42 (1990); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989); *Katchen v. Landy*, 382 U.S. 323 (1966). As explained in *Granfinanciera*, the Court's holdings on this issue turned not on the ground that a bankruptcy court is a court of equity, but rather, on the bankruptcy court's having "actual or constructive possession" of the bankruptcy estate and its "power and obligation to consider objections by the trustee in deciding whether to allow claims against the estate." 492 U.S. at 57.

rights of competing creditors in a bankruptcy estate are adjudicated. A creditor who chooses to participate in this unique process by filing a proof of claim necessarily subjects itself to the rules applicable to that process. *Langenkamp v. Culp*, 498 U.S. 42, 44 (1990) ("by filing a claim against a bankruptcy estate the creditor triggers the process of 'allowance and disallowance of claims', thereby subjecting himself to the bankruptcy court's equitable power."). As a result, rights enjoyed by creditors outside the bankruptcy context may no longer apply once the creditor files a proof of claim. Sound federal policy mandates that in bankruptcy, all claimants, including state and federal taxing authorities, should bear the burden of persuasion to establish their claims.

CONCLUSION

For the reasons stated herein and in the Brief for Petitioner, petitioner respectfully requests that the judgment of the court of appeals be reversed.

Respectfully submitted,

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